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No. _____

In The

Supreme Court of the United States

October Term, 1982

—o—

THE DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Petitioner,

vs.

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF MISSOULA, AND HAVRE FEDERAL SAVINGS AND LOAN ASSOCIATION

Respondents.

—o—

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF MONTANA

—o—

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QUESTION PRESENTED FOR REVIEW

Whether The State of Montana Can Include Interest Income From Certain Federal obligations (*i.e.*, 31 U.S.C. §769 and 12 U.S.C. §§1433, 1725(e), 2055, 2079, 2134), in the net income measurement of the Montana Corporation License Tax imposed by Sections 15-31-101 *et seq.*, Montana Code Annotated.

A. Whether the Montana Corporation License Tax Satisfies the Requirements of the Exception Contained in 31 U.S.C. §742, so as to Allow the Inclusion of Federal Interest Income Within the Computation of its Tax Base.

B. Whether the Immunity From State Taxation Described in 31 U.S.C. §769 and 12 U.S.C. §§1433, 1725(e), 2055, 2079, 2134 is Broader than that Otherwise Provided by 31 U.S.C. §742.

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Respondents.

—o—

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF MONTANA

—o—

The Petitioner, the State of Montana, respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the Supreme Court of Montana entered in this case.

OPINION BELOW

The Opinion of the Montana Supreme Court is reported at *First Federal Savings & Loan Association v. Department of Revenue*, ____Mont.____, 654 P.2d 496 (1982). A copy of the Opinion of the Montana Court appears in the Appendix, pp. 1a-10a.

JURISDICTION

The Opinion of the Montana Supreme Court was entered on September 23, 1982. A timely Petition for Rehearing was denied by a split court on December 6,

1982, Appendix pp. 11a-12a, and this Petition for Certiorari was filed within 90 days of that date. Accordingly, this Petition is timely under 28 U.S.C. §2101(c) and Supreme Court Rule 20.

The jurisdiction of this Court is invoked under 28 U.S.C. §1257(3).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case concerns the tax exception contained in 31 U.S.C. §742. Also involved are certain provisions of the Montana Corporation License Tax, in particular §§15-31-101(3), 15-31-143(1) and 15-31-113(1)(a)(i), of the Montana Code Annotated. The following statutes are also involved in this case, but because of their length are set out verbatim in the Appendix, pp. 34a-36a: 31 U.S.C. §769 (United States Treasury Bills); 12 U.S.C. §§ 1433 (Federal Home Loan Bank Notes), 1725(e) (Federal Savings & Loan Insurance Corporation Notes), 2055 Federal Land Bank Obligations), 2079 (Federal Farm Credit Bank Securities), and 2134 (Federal Home Loan Stock Dividends).

31 U.S.C. §742:

> Exemption From Taxation
>
> Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

Montana Code Annotated:

15-31-101. Organizations subject to tax

* * *

(3) Every corporation, except as hereinafter provided and except as provided in 33-2-705(6), engaged in business in the State of Montana shall annually pay to the state treasurer as a license fee for the privilege of carrying on business in this state such percentage or percentages of its total net income for the preceding taxable year at the rate hereinafter set forth. In the case of corporations having income from business activity which is taxable both within and without this state, the license fee shall be measured by the net income derived from or attributable to Montana sources as determined under part 3. This tax is due and payable on the 15th day of the 5th month following the close of the taxable year of the corporation; however, the tax becomes a lien as provided in this chapter on the last day of the taxable year in which the income was earned and is for the privilege of carrying on business in this state for the taxable year in which the income was earned.

15-31-143. Return and payment on corporate dissolution. (1) It is hereby declared that the policy of the State of Montana, both at the time of the enactment of the corporation license tax law and at all times since, has been and still is that every corporation doing business in Montana shall pay an excise tax for the exercise of such privilege and that the amount of such tax shall be based upon the total taxable net income of such corporations during the entire period of time they are engaged in business in this state. No remission of that obligation for the last year in which a corporation engages in business in Montana was intended by the original enactment of this section.

15-31-113. Gross income and net income. (1) The term "gross income" means all income recognized in determining the corporation's gross income for federal income tax purposes and: (a) including: (i) interest exempt from federal income tax;

STATEMENT OF THE CASE

Respondents, First Federal Savings and Loan Association of Missoula and Havre Federal Savings and Loan Association are federally chartered savings and loan associations doing business in the State of Montana in corporate form. As such, Respondents are subject to the Montana Corporation License Tax provided for in Title 15, Chapter 31 of the Montana Code Annotated (MCA).

In their respective corporation license tax returns for tax year 1979, Respondents deducted the interest income derived from certain federal obligations from their gross income to arrive at net income for purposes of measuring the Montana Corporation License Tax. Subsequently, Petitioner, the Montana Department of Revenue audited the returns, disallowed the deduction taken for interest income on certain United States obligations and issued notices of resulting tax deficiencies.

Thereafter, Respondents filed suit in the District Court of the First Judicial District of the State of Montana for the County of Lewis and Clark, contending in their complaint for Declaratory Judgment as follows:

> 16. Plaintiffs contend that while 31 U.S.C. Section 742, as a general rule, authorizes the inclusion of interest income from United States obligations in the calculation of net income for purposes of a nondiscriminatory corporation license tax, this federal statute does not repeal, amend, nullify or control the specific federal statutes relating to the federal securities listed on "Exhibit A" wherein it is provided that the interest income from these securities is specifically exempted from any form of state taxation which would include corporation license taxes.
>
> 17. The federal statutes pertaining to the federal securities shown on "Exhibit A", being more specific than the general statute regarding state taxation of interest income from obligations of the United States must be, and are,

controlling in determining whether the interest income from such securities is taxable.

In answer to the Respondents' Complaint, the Montana Department of Revenue contended that the inclusion of interest income from federal obligations in the net income measurement of a corporation franchise tax is permissible under the express language of 31 U.S.C. §742 and pursuant to a long line of decisions of this Court interpreting the exemption language of §742 as not extending to a nondiscriminatory franchise tax.

The Respondents never questioned that the Montana Corporation License Tax is anything other than an excise tax on the corporate franchise. See Items 13, 15 and 18 of Complaint, Appendix, pp. 38a-50a.

Pursuant to the filing of a Motion for Summary Judgment by each party the trial court held that interest income from the specified federal obligations were includable in the computation of the Montana Corporation License Tax pursuant to 31 U.S.C. §742 as well as the established line of case law emanating from this Court interpreting this section, and entered judgment on behalf of the Petitioner.

The Memorandum and Order of the District Court appears in the Appendix at pp. 13a-27a.

The Respondents herein appealed the order of the District Court to the Montana Supreme Court which reversed and held that the inclusion of the interest income from the specified federal obligations in the net income measurement of the Montana Corporation License Tax violated both 31 U.S.C. §742 and the federal agency statutes providing for issuance of such obligations (31 U.S.C. §769; 12 U.S.C. §§1433, 1725(e), 2055, 2079, and 2134). In reaching that conclusion the Montana court declined to address, discuss or recognize the 100 plus year

interpretation given to the exemption language contained in 31 U.S.C. §742 by this Court, upholding inclusion of federal interest income in the measure of a state franchise tax.

A second issue presented to the Montana Supreme Court by the Respondent but left undecided was whether the Montana Corporation License Tax is discriminatory. The Montana Court determined this second issue to be moot in light of its decision on the first issue, 654 P.2d at 499, however it will be addressed in this Petition. The Montana Court also addressed a third issue concerning the application of a 1979 legislative amendment to the net loss carryover provisions of the Montana Corporation License Tax statutes. This third issue being solely a matter of state law is not raised into issue in this Petition.

REASONS FOR GRANTING THE WRIT OF CERTIORARI

A. THE MONTANA SUPREME COURT'S DECISION ON THE FEDERAL QUESTION CONFLICTS WITH APPLICABLE DECISIONS OF THIS COURT AND OTHER STATE COURTS OF LAST RESORT.

INTRODUCTION

This Court issued a decision on January 24, 1983 in *Memphis Bank and Trust Company v. Riley C. Garner*, ____U.S.____, 51 U.S.L.W. 4104, which held a Tennessee franchise tax law imposing a 3% tax on the net earnings of banks doing business within the state, unconstitutionally discriminatory under the Supremacy Clause. The rationale of this Court's holding was that although interest income from federal obligations is includable in certain instances in the base of the tax, since interest income from otherwise comparable state and local obligations was excluded therefrom the state tax was

discriminatory. The issue now presented to this Court for review was not directly addressed in *Memphis Bank and Trust Company* but was specifically referred to and set forth in Footnote 5 to the Opinion, 51 U.S.L.W. at 4105, as follows:

> In establishing the Federal Credit Banks, Congress made clear that the obligations of these banks would be immune from taxation by the States. 12 U.S.C. §§2055, 2079 and 2134. We have no occasion to determine whether the immunity described in these provisions is broader than that otherwise provided by 31 U.S.C. §742. . . .

This Court now has the opportunity to directly address this particular issue which possesses significant import for not only the State of Montana and its citizens, but all states which levy a "nondiscriminatory franchise tax or other nonproperty tax in lieu thereof on corporations" and include in the measure of such tax interest income from otherwise tax exempt federal obligations. In addition, this issue affects more than 120 years of jurisprudence from this Court in the federal and state franchise taxation area.

If the issue is left unaddressed, states such as Montana will continue to endure the dilemma of finding a method which effectively taxes financial institutions engaged in business within the state so as to truly reflect such institutions' fiscal responsibilities to the state and more importantly to its fellow citizens. Historically, this has been an ongoing and frustrating problem for the State of Montana. See, *Montana Bankers Association v. Montana Department of Revenue*, 177 Mont. 112, 580 P.2d 909 (1978) (holding that the 1959 congressional amendment to 31 U.S.C. §742 prohibits the inclusion of the value of federal obligations in the assets of a national bank for purposes of computing a bank shares tax).

Section 742, after being amended in 1959, was marked by an absence of litigation for more than 20 years. The

Montana Supreme Court's interpretation of 31 U.S.C. §742 in the *Montana Bankers Association* case *supra*, appears to be one of the first state court decisions since the amendment on what was thought to be a settled issue. Since then however, numerous cases relating to that specific issue have arisen. It must be noted the issue has not been resolved uniformly since the highest courts in these states have opted for an interpretation of 31 U.S.C. §742 *contra* to that of the Montana Court. Cf.: *Bartow County Bank v. Bartow County Board of Tax Assessors*, 285 S.E. 2d 920 (Ga. 1982), *appeal docketed*, No. 81-1834, 51 U.S.L.W. 3023 (April 5, 1982) (holding Georgia bank shares tax consistent with 31 U.S.C. §742); and also *Bank of Texas v. Childs*, 615 S.W. 2d 810 (Tex. 1981), cert. granted sub nom. *American Bank and Trust Co. v. Dallas County*, ____U.S.____, 51 U.S.L.W. 3339 (1982) (No. 81-1717) (holding that the State of Texas' property tax on bank shares which is computed on a bank's net assets without any deduction for tax-exempt United States obligations owned by a national bank is not violative of 31 U.S.C. §742).

As can be noted, the effects of the Montana Supreme Court's construction of 31 U.S.C. §742 are beginning to surface in this Court in the bank shares tax area and are requiring the attention of this Court to settle. Now, this unprecedented interpretation of 31 U.S.C. §742 threatens to permeate the area of state franchise taxation. If left unaddressed from this Petition, the Montana Supreme Court's interpretation of 31 U.S.C. §742 will once again pervade the courts of other states and ultimately wind themselves to this Court. This Court can speak definitively on this most important issue by granting this Petition.

DISCUSSION

The decision of the Montana Supreme Court that interest income from certain federal obligations is not in-

cludable in net income for purposes of calculating the Montana Corporation License Tax (which is a franchise income tax), is in derogation of the long established judicial interpretation of 31 U.S.C. §742 developed by this Court, affirming the inclusion of otherwise tax exempt obligations or interest therefrom in the measure of a corporate franchise tax pursuant to 31 U.S.C. §742. In addition, the decision of the Montana Supreme Court is contrary to the recorded congressional intent enacting the 1959 amendment to §742.[1] *See, also,* Symons, *State Taxation of Banks: Federal Limitations*, 99 Banking L.J. 817 (1982).

The issue before the Court in this petition involves the question of when a state can levy a tax involving obligations of the United States. Initially, any state tax must meet the requirements of the exception contained in 31 U.S.C. §742 which expressly provides that such state taxation must first be nondiscriminatory and second must be either a "franchise tax" or "other nonproperty tax in lieu thereof imposed on corporations".[2] It is after these two requirements are satisfied that the subsequent federal issue of this Petition presents itself, *i.e.*, the interpretation to be given to exemption language contained in the federal agency statutes.

The holding of the Montana Supreme Court in this matter ignores the historical treatment of state excise taxation by this Court and fails to recognize that under certain parameters federal interest income can be legally embraced in state taxation according to 31 U.S.C. §742. The

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1. *See*, S.Rep. No. 909, 86th Cong., 1st Sess., reprinted in 1959, U.S. Code Cong. & Ad. News, 2769, 2773-74, and 2777.

2. 31 U.S.C. §742 also excepts "estate taxes or inheritance taxes" but are not at issue in this Petition.

statute under consideration, 31 U.S.C. §742 was enacted in 1862 and provided that "all stocks, bonds, and other securities of the United States held by individuals, corporations, or associations within the United States shall be exempt from taxation by or under state authority." Act of Feb. 25, 1862, Ch. 33, §2, 12, Stat. 346.

An initial reading of the express words of the statute appeared to indicate an all encompassing prohibition of any state taxation which utilized federal obligations or interest therefrom. However in early watershed decisions, this Court clarified construction of the statute and sanctioned certain areas of exception regarding state taxation, thereby curtailing an overly broad interpretation of §742. Two general areas regarding the taxation of state granted privileges have been recognized by this Court as being allowable, notwithstanding the prohibition of §742. The two areas of allowable taxation are the franchise and inheritance tax areas, in which the state levies a tax for the respective privileges of doing business within the state, *Society for Savings v. Coite*, 6 Wall. 594 (1867); *Provident Institution for Savings v. Massachusetts*, 6 Wall. 611 (1867); *Hamilton Co. v. Massachusetts*, 6 Wall. 632 (1867), and transmitting or receiving of property via a testamentary or intestate devise, *Plummer v. Coler*, 178 U.S. 115 (1900).

Congress amended 31 U.S.C. §742 in 1959 so as to expressly ratify and thereby reinforce the judicially developed exceptions to the state taxation exemption contained in §742. The amendment enumerated two requirements which must be satisfied in order to qualify as an exception to the §742 state taxation exemption. The tax must first be either a "franchise tax" or "other nonproperty tax in lieu thereof" imposed on corporations. Subsequent to the 1959 amendment this Court upheld a franchise tax utilizing a net income measure that included

interest income from federal obligations. *See, Reuben L. Andersen-Cherne, Inc. v. The Commissioner of Revenue of Minnesota*, 423 U.S. 886 (1975) (Appeal dismissed for lack of a substantial federal question, and thus constituting a disposition on the merits of the case and concomitantly binding precedent for all courts. *See, Hicks v. Miranda*, 422 U.S. 332 (1975)). Secondly the tax must be "nondiscriminatory". *See, Memphis Bank and Trust, supra*. The Montana Corporation License Tax fulfills both of these requirements.

The Montana Corporation License Tax constitutes a "franchise or other nonproperty tax in lieu thereof imposed on corporations" within the meaning of 31 U.S.C. §742. Montana statutes expressly describe the tax as a license fee for the privilege of carrying on business within the state in corporate form. *See*, §§15-31-143(1) and 15-31-101(3), MCA, *supra*. The Montana Supreme court has held innumerable times that the corporate license tax is a franchise tax upon the privilege of doing business in the State in a corporate capacity. *Montana Bank v. Casey*, 135 Mont. 104, 337 P.2d 935 (1959); *State v. J. C. Maguire Const. Co.*, 113 Mont. 324, 125 P.2d 433 (1942); *O'Connell v. State Board of Equalization*, 95 Mont. 91, 25 P.2d 114 (1933); *East Helena State Bank v. Rodgers*, 73 Mont. 210, 236 P. 1090 (1925); *Cottonwood Coal Co. v. Junod*, 73 Mont. 392, 236 P. 1080 (1925); *Equitable Life Assur. Co. v. Hart*, 55 Mont. 76, 173 P. 1062 (1918). As already noted the Respondents never questioned the nature of the Montana corporation license tax in their Complaint[3] or otherwise and conceded in their

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3. *See, generally*, Respondent's Complaint, reproduced in Appendix, pp. 38a-50a.

Complaint[4] as well as in their briefs[5] to both the Montana Supreme Court and the State District Court that the tax was a franchise tax.

The Montana Supreme Court described the tax in its Opinion issued in this matter as follows, 654 P.2d at 498:

> The Department argued that the Montana Corporation License Tax is a franchise tax on the privilege of doing business in Montana with the tax based upon or measured by the net income of the taxpayer. Hence, it was argued, that the tax is not on the property (interest income) but is on the privilege. This Court finds the argument to be unpersuasive. It is a distinction without a difference in our opinion. *If the franchise tax is on the privilege and the tax is based on the net income, this Court concludes that the tax is on the privilege and the net income.* If the net income includes tax-exempt interest, the tax is on the exempt income which is prohibited by the specific federal statutes creating the federal obligations and granting the tax exemption.

It appears clear that the Montana corporation license tax is a franchise tax. However, if the tax is somehow construed not to be a franchise tax, at very least it is a "non-property tax in lieu thereof imposed on corporations" and still falls within the §742 exception.

In addition to the Montana Corporation License Tax constituting the type of tax contained within the exception

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4. *See*, Respondent's initial Protest to the Department specifically incorporated as Exhibit "C" via item 13 of the Complaint which states: "taxpayer admits that generally interest income from United States obligations is taxable for purposes of the Montana Corporation License Tax".

5. *See, e.g.*, Respondent's Reply Brief to Montana Supreme Court, p. 2; Reply Brief to Montana District Court, p. 3, both reproduced in Appendix, pp. 51a-52a.

to 31 U.S.C. §742, it also meets the second requirement in that it is nondiscriminatory. As has been already noted, a second issue presented to the Montana Supreme Court in this matter was whether the Montana corporation license tax is discriminatory. Although the Montana court determined this second issue to be moot in light of its decision on the first issue, the Department successfully prevailed at District Court that the Montana tax is not discriminatory since it includes interest income derived from all obligations issued by the State of Montana or any political subdivision thereof, any sister state, or the United States. This is all that is required by §742 according to *Memphis Bank and Trust Company*, 51 U.S.L.W. at 4105:

> It is clear that under the principles established in our previous cases, the Tennessee bank tax cannot be characterized as nondiscriminatory under §742. Tennessee discriminates in favor of securities issued by Tennessee and its political subdivisions and against federal obligations. The State does so by including in the tax base income from federal obligations while excluding income from otherwise comparable state and local obligations. We conclude, therefore, that the Tennessee bank tax impermissibly discriminates against the Federal Government and those with whom it deals.

Notwithstanding that interest income from all obligations are included in the base of the Montana tax, it was argued by the Respondents that because statutes providing for issuance of certain Montana obligations[6] contain tax exempting language, the result is a discriminatory tax. The District Court affirmed the position of the Department that the Montana Corporation License Tax clearly

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6. §§ 7-7-4607, 7-13-2330, 7-14-4654, 7-15-4307, 7-34-2416, 60-11-1110, 60-11-1210, 67-11-306, and 90-6-125, MCA. See Appendix, pp. 53a-54a, for Complete Text of Statutes.

includes in the measurement of the tax, interest income from all Montana obligations. The basis of the District Court's holding, and the Petitioner's argument is that the statutes' tax exempting language prohibits all forms of state taxation except a franchise tax, since such tax does not tax the income but taxes the corporate privilege. Such rationale is supported by decisions of this Court interpreting §742 prior to the 1959 amendment, and the Montana Supreme Court, as well as other federal excise tax decisions.

B. THE MONTANA SUPREME COURT DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN BUT SHOULD BE SETTLED BY THIS COURT.

The imposition by the State of Montana of a corporation license tax which includes interest income from federal obligations in its measuring base is plainly in accord with 31 U.S.C. §742. It is at this point that a question of uniform interpretation of federal statutes presents itself. This Court has never directly addressed the issue of whether the tax immunity described in the specified statutes (31 U.S.C. §769 and 12 U.S.C. §§1433, 1725(e), 2055, 2079, 2134) is broader than that otherwise provided by 31 U.S.C. §742. *See, Memphis Bank and Trust Company v. Riley C. Garner, supra*, fn. 5. This Petitioner believes that the tax exempting language in §742 provides clear guidance as to the interpretation to be given to the exemption language contained in those statutes. The Montana Supreme Court held otherwise and ruled without stating its reason that the specific federal statutes creating the federal obligations prohibit the inclusion of federal interest in the net income measure of the Montana corporation license tax, notwithstanding the interpretation given to the tax exemption language in §742 by this Court. 654 P.2d at 498.

It must be noted that the specific statutes providing for issuance of certain federal obligations contain language exempting the obligations from state taxation. That language is virtually identical to the exempting language contained in the first sentence of 31 U.S.C. §742, which prior to 1959 comprised the entire statute. Because the language is so similar, the same interpretation of the exempting language given to §742 is applicable to the individual agency statutes. The prohibition on state taxation of federal obligations as contained in §742 does not apply to state franchise taxation. The state tax prohibitions contained in the issuing statutes likewise does not apply to a state franchise tax such as the Montana Corporation License Tax.

Beginning in 1862 this Court interpreted §742 and instituted a long line of decisions upholding the position that states could levy a franchise or excise tax for a granted privilege such as operation in corporate form, and that in computing the value of that privilege consideration of the value of federal obligations held as assets did not violate §742. In short, states could tax the franchise and include the value of interest income from federal obligations in the income measurement. *See, Society for Savings v. Coite*, 6 Wall. 594 (1867); *Provident Institution for Savings v. Massachusetts*, 6 Wall. 611 (1867); *Hamilton Co. v. Massachusetts*, 6 Wall. 632 (1867); *Home Insurance Company v. New York State*, 134 U.S. 594 (1890); *Cleveland Trust v. Landers*, 184 U.S. 111 (1902); *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911); *Educational Films Corporation v. Ward*, 282 U.S. 379 (1931); *Pacific Co. v. Johnson*, 285 U.S. 480 (1932); and *Werner Machine Co. v. Director of Taxation*, 350 U.S. 492 (1956). Succinctly stated, the latest ruling announced in these cases was that a franchise tax does not violate 31 U.S.C. §742 merely because it is measured by a yardstick which includes tax-

exempt income or property, even though a part of the economic impact of the tax may be said to bear directly upon such income or property. *See, Werner Machine Co.*, 350 U.S. at 494.

In 1959 the second sentence was added to 31 U.S.C. §742. As noted in the legislative history, treatises, and by the Montana District Court, although not addressed by the Montana Supreme Court, this second sentence was but a clarification of the exemptive provision contained in the original sentence which expressly ratifies and reinforces the line of decisions announced by this Court interpreting §742. That line of cases specifically allows a state to levy a nondiscriminatory franchise tax which includes federal interest income in its measure.

In none of these cases, however, was the argument directly addressed as to whether the exempting language contained in the individual statutes providing for issuance of federal obligations is broader than the exemption provided for in 31 U.S.C. §742. A need for guidance from this Court is evident since the issue presented by this petition is significant and potentially far reaching. The issue of a state's ability to levy a corporate franchise tax and choose a method of measurement which it considers the most appropriate to the exercise of that corporate franchise, deserves plenary consideration by this Court. This case offers a timely opportunity for the court to set the matter to rest.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Supreme Court of Montana.

Respectfully submitted,

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